



CIO OFFICE MORNING MARKET WRAP – Sunday September 27th, 2020. ALSO AVAILABLE ON ALEXA.

Despite a rebound on Friday, last week was broadly negative on global markets across asset classes, paving the way for September to be the first negative month since March. This is not only about stocks, which logically experience a correction as their elevated valuations meets rising uncertainties. Indeed, the worst performing asset last week was Gold, down -4.6%, and all the segments of fixed income were also in the red, including US government bonds. Usually, when both cyclical and defensive assets move in the same direction, the explanation has to be found in central banks' action which either lifts all boats, or puts pressure on all of them. On that front however, there were no notable news, and certainly absolutely no indication of any tightening in sight. If anything, it has become extremely clear that interest rates will remain close to zero or below in most developed economies, and that quantitative easing is not anymore an unconventional tool but an essential part of the new normal monetary policy. What they also say, however, is that they can't do much more at this stage, and that fiscal stimulus is now essential to support growth.

Talking about economic backdrop: the cycle has been reset by the pandemic, and the West is now in the process of restarting it. Central Banks have been very quick at acting and as a result markets have been very quick at pricing-in a perfect recovery. This perception was confirmed by the initial strong pace of the rebound, as economies reopened, printing very high instant growth from a very low basis. As we highlight for long, we have no doubt in the recovery but have always seen it as uneven, potentially erratic, and certainly long. The combination of a virus resurgence in the West with the stalled US negotiations on their next stimulus package is very logically clouding the near-term outlook and affecting cyclical assets. This is not surprising, and we should be prepared to weeks of uncertainty until the name of the US President for the next 4 years will be known. In the meantime, the campaign is raging. President Trump nominated yesterday his third justice to the US Supreme Court, which will certainly raise opposition from the Democrats as this cements the Republican shift in the institution. On the geopolitical front, the US administration imposed sanctions on SMIC, China's largest chipmaker, threatening to stop their access to US technology. Finally the virus numbers are not good, with an acceleration in the number of cases in most of the countries.

Having said that, everything is not gloomy in the current economic backdrop: regionally, China is booming, with positive implications for their commercial partners, including Europe. In terms of sectors, services are directly hit by the social distancing context but goods keep on surging. The current depression in services is 100% covid related and unless we find ourselves in the worst possible scenario of an unbeatable virus, a vaccine should kick the door open for a spectacular rebound. In the meantime, cyclical assets are volatile, and defensive assets are at best a store of value, while they at worse pose a risk-management problem: their valuations are too elevated to let them play their natural contra-cyclical role. How lower can interest rates go when the starting point for the 10 year are respectively +0.6% for the US and -0.5% for Germany? Especially when Central Banks clearly indicate that they will not increase their support in the short-term? Gold is a bit paradoxically also affected by cyclical concerns: as growth forecasts are lower, inflation expectations are weakening. But since nominal rates are already too low to reflect lowered growth prospect, this means that real interest rates, i.e. nominal rates minus inflation expectations, are rising, which is a headwind for the precious metal. This explains why last week's drop was significant. We are still overweight on Gold, the currency you cannot print, but acknowledge that it is currently correlated to everything else.

Against such a backdrop, it's good to keep in mind that institutional money could take the current risk-off configuration to start reducing their underexposure to equities – putting their piles of cash at work. The short-term is dominated by US politics, with the major risk of a contested election result but in the meantime the probability of a minimal deal on fiscal stimulus is not to be excluded. This rumor was the reason why US stocks closed on a positive note on Friday. We haven't changed our positioning and think that it is not the time to take any radical decision: the medium term is favorable, and the short term is impossible to predict.

In the week ahead, we will obviously keep on monitoring the virus numbers especially in Europe where the pandemic is widening. The Brexit situation is not getting better either, with palpable tensions rising as a formal round of discussions is scheduled in Brussels. The first US Presidential debate will take place on September 29th, just before an avalanche of economic indicators, from PMIs to the US monthly job report on Friday.

Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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